

Labour market development and policy in Iceland

1 Recent labour market developments

1.1 Unemployment and participation rates

Low unemployment has generally characterised the rather flexible Icelandic labour market. During the period 1991-2008, estimated unemployment averaged 2.7 per cent, peaking at 5.0 during the contraction of the early 1990s (see Figure 1). In 2008, registered unemployment was only 1.6 per cent, but rose to 8.0 per cent the next year and to 9.0 per cent on average in the period January-May 2010.

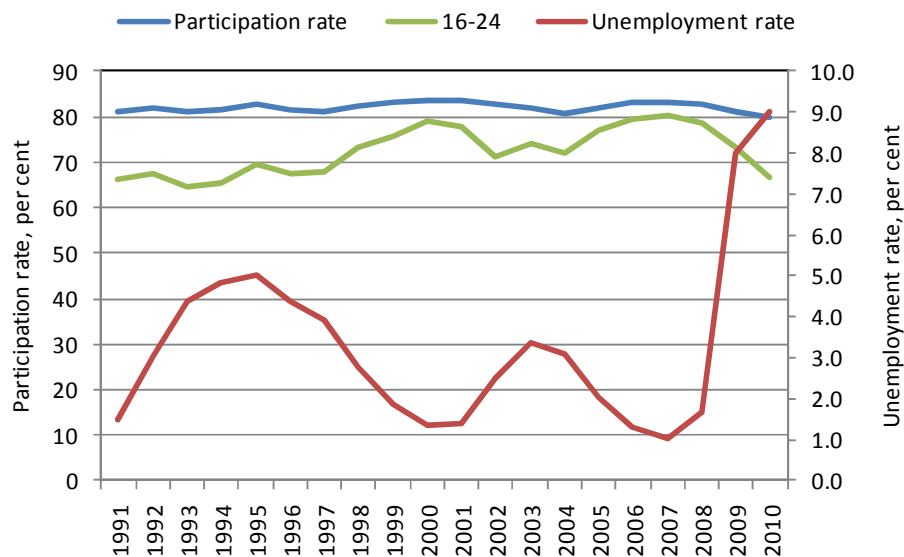


Figure 1 Labour market participation and unemployment in Iceland 1991-2010.

Source: Statistics Iceland and Directorate of Labour.

Labour participation rates have in recent years been higher in Iceland than in any other OECD-country. During the 1990s, the overall participation rate increased from about 81.5 per cent in the first years of that decade to 83 per cent towards the end of the decade. In 2010, the labour force participation rate dipped below 80 per cent for the first time in 20 years. Thus, although the current crisis is much greater than the one in the early 1990s, labour force participation is about the same. The participation rate of young people aged 16-24 shows a rather strong upward trend in the first half of the period, peaking at 79.2 per cent in 2000. It then decreased slightly before picking up again and reaching 80.1 per cent in 2007. The young are most vulnerable to changes in economic conditions, as evidenced by the rapid decline in their participation following the crash in the autumn of 2008. The participation rate was

down to 66.8 per cent in the first quarter of 2010, 13.3 percentage points lower than before the crisis.

The relationship between economic growth and unemployment and labour force participation is analysed further in Figure 2 which shows quarter-on-quarter growth of GDP and percentage point changes in the unemployment and participation rates. It is evident that changes in economic growth had only minor short-run effects on employment and labour participation until 2008, when the effects become more pronounced. Thus, unemployment rose by 2.5 percentage points in the last quarter of 2008, as the economy contracted by 0.9 per cent and by 6.9 percentage points in the first quarter of 2009 when GDP fell by 7.7 per cent. Figure 2 also illustrates well the close correlation between the decline in GDP and the participation rate of the youngest group in the autumn of 2008 and first half of 2009.

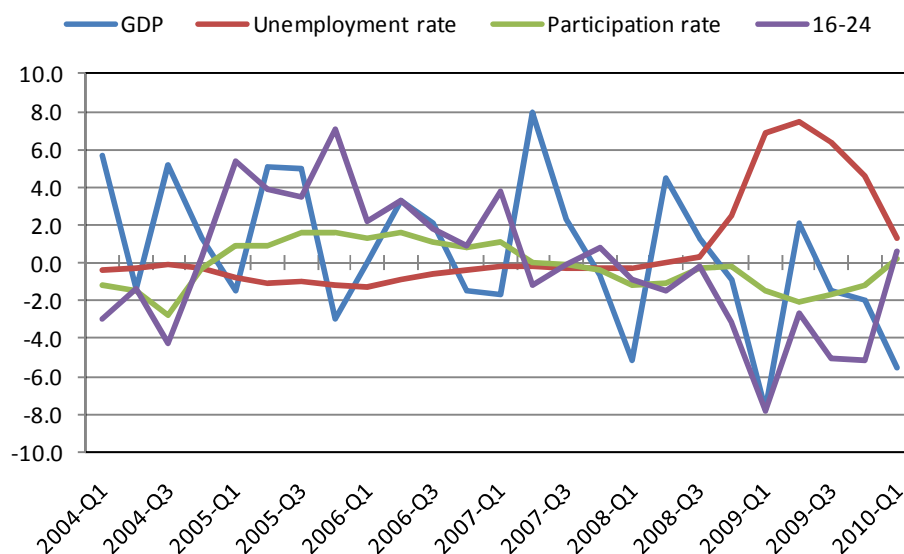


Figure 2 Quarter-on-quarter per cent changes in GDP and percentage points changes in unemployment and labour force participation rates 2004-2010.

Source: Statistics Iceland.

It should be pointed out that Statistics Iceland estimates of the unemployment rate are higher than the estimates of Directorate of Labour when unemployment is low and lower in times of high unemployment. In the last two quarters of 2009 and the first quarter of 2010, the DoL estimates were 1.2-1.6 percentage points higher than those of Statistics Iceland.

The development of unemployment is very much in line with recent projections. Thus the 2010 budget estimated unemployment would reach 10.6 per cent in 2010, before subsiding to 9.0 per cent in 2011 and 6.1 per cent in 2012. The estimates of Statistics Iceland for 2010 and 2011 are slightly lower, but about the same for 2012.

A recent Central Bank publication points out that registered unemployment will measure 0.5-1.0 percentage points lower in 2010 because the eligibility of self-employed persons for unemployment benefits has been curtailed¹. Students on leave from studies – for instance while on summer holidays – are also no longer entitled to benefits.

1.2 A closer look at unemployment

Unemployment was more prevalent among women immediately after the crunch, but since then more men have been without a job. In May 2010, the unemployment rate for males was 8.8 per cent and 7.7 per cent for females.

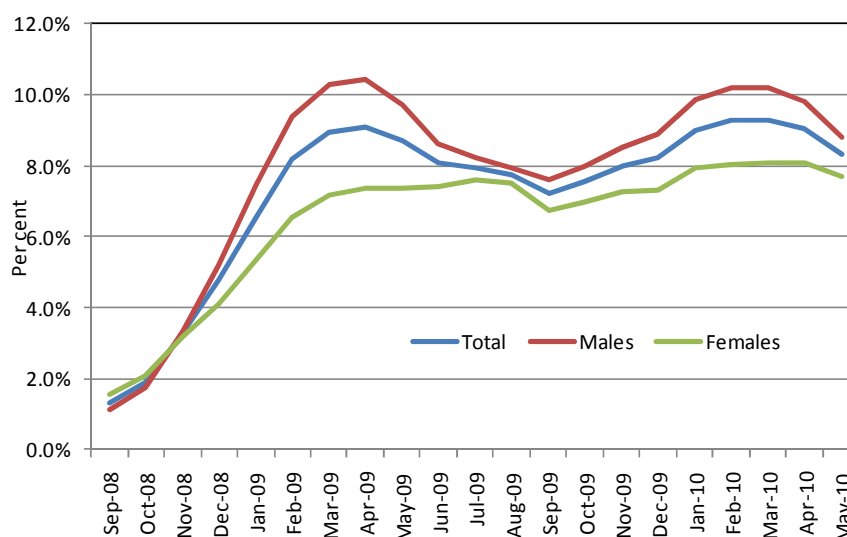


Figure 3 Unemployment by gender September 2008-May 2010.
Source: Directorate of Labour.

The Directorate of Labour does not publish information on the unemployment rate for different age groups, only the number of individuals without work. However, Statistics Iceland has data on unemployment by age and these are presented in Figure 4. As is usually the case, young people are by far the most likely to be unemployed. The unemployment rate among young males is typically almost three times that of prime aged males aged 25-54, while the rate among young women is twice what is for older females. Unemployment of the youngest groups varies greatly between seasons. It is usually highest in the second quarter, when the school year ends in both secondary schools and universities, but lower in the third quarter as students return to their studies. However, recent changes to the Unemployment

¹ Central Bank Monetary Bulletin 2010-2. Available at:
<http://www.sedlabanki.is/lisalib/getfile.aspx?itemid=7785>.

Benefits Act that reduce the entitlement of students to unemployment benefits should reduce this seasonality in the future.

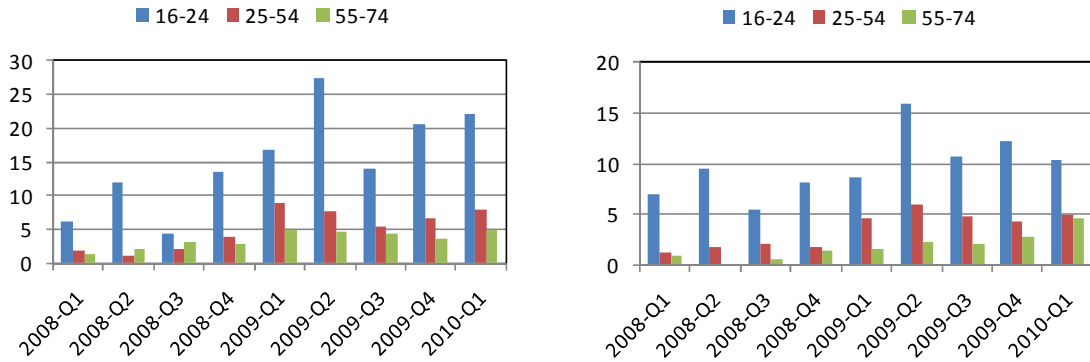


Figure 4 Unemployment among males (left) and females (right) by age groups 2008Q-2010Q1.

Source: Statistics Iceland.

Falling demand immediately following the crisis at first increased the number of unemployed persons, and thereby the percentage of those unemployed for relatively shorter periods. Thus, during the period September 2008-February 2009 two out of three had on average been unemployed for less than three months. By April 2010, that proportion was down to 20 per cent. Through time, though, the share of the long-term unemployed has risen. In the first six months only one in 20 had been without a job for more than a year, but by the spring of 2010, almost three in ten had been unemployed for more than a year.

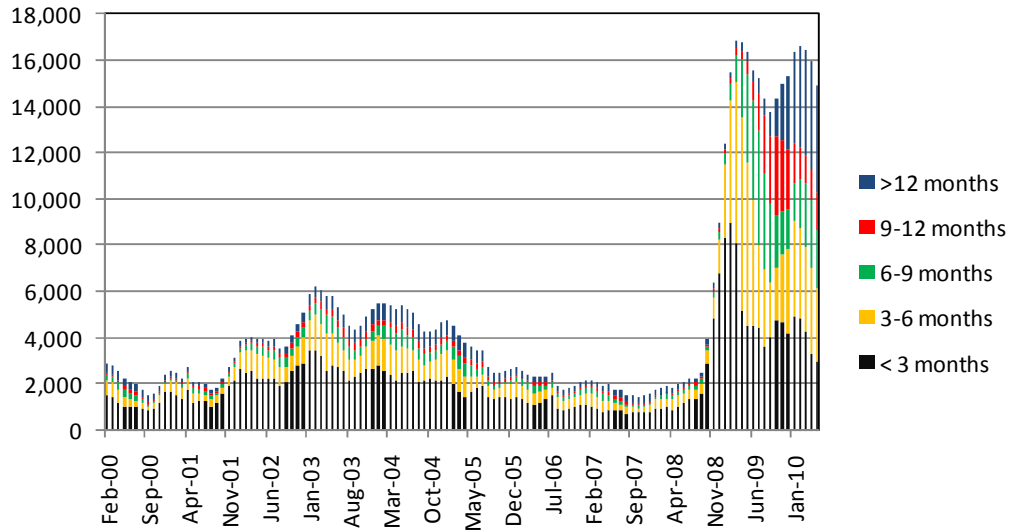


Figure 5 Duration of unemployment February 2000-May 2010.
Source: Directorate of Labour.

Figure 6 demonstrates the correlation between unemployment and long-term unemployment, where the latter is defined as those without a job for more than 12 months. Two things stand out. First, the relative decline in long-term unemployment immediately after the crisis is a clear outlier. Second, the rapid increases in long-term unemployment between 2008 and 2009.

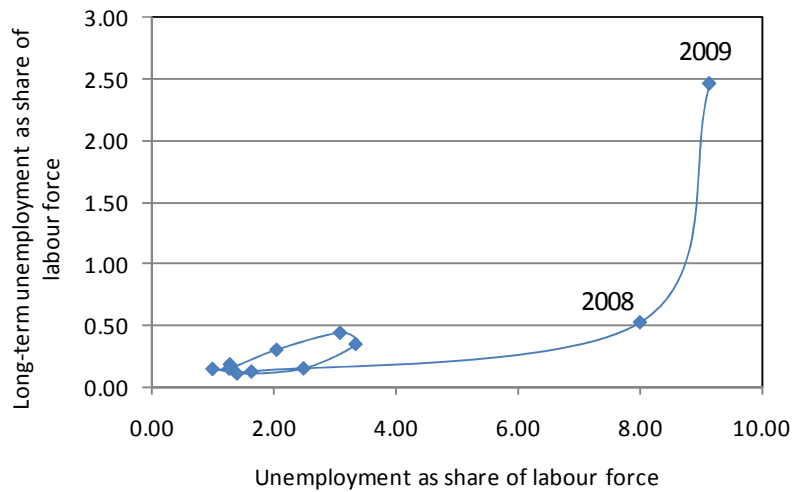


Figure 6 Correlation between unemployment and long-term unemployment 2000-2009.
Source: Directorate of Labour.

In Figures 7-9, data from the Directorate of Labour are used to break unemployment down by education, profession and economic activity. These figures do not report the unemployment rate for each group, but rather the number of unemployed in each subgroup. As shown in Figure 7, most of those unemployed have limited education. Thus, 50-60 per cent of the unemployed have usually only finished elementary school or have less education. A similar number of the unemployed have finished vocational school, secondary school, or hold a university degree.

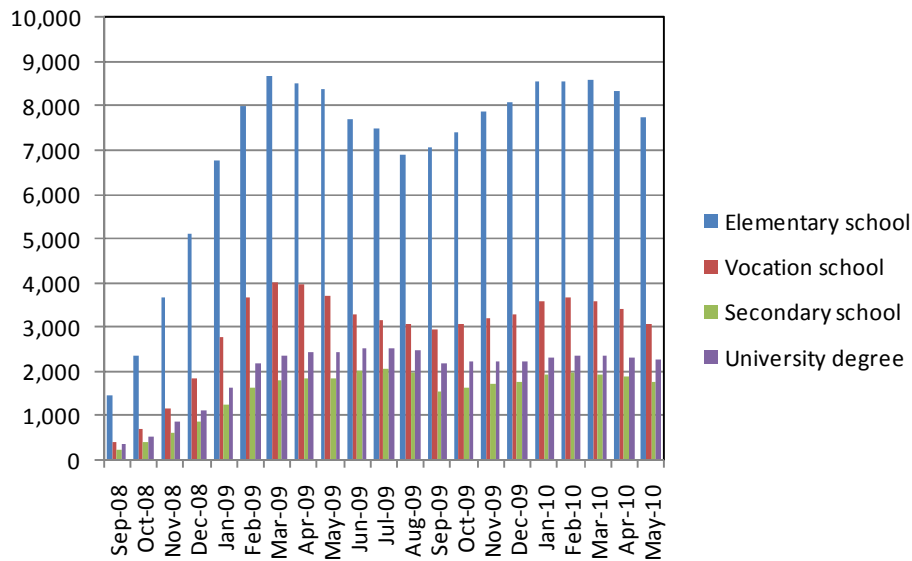


Figure 7 Unemployment by education September 2008-May 2010.

Source: Directorate of Labour.

Most of the unemployed previously worked in the private services, but many also in manufacturing and construction. Relatively few employed by the primary or public sectors have lost their jobs.

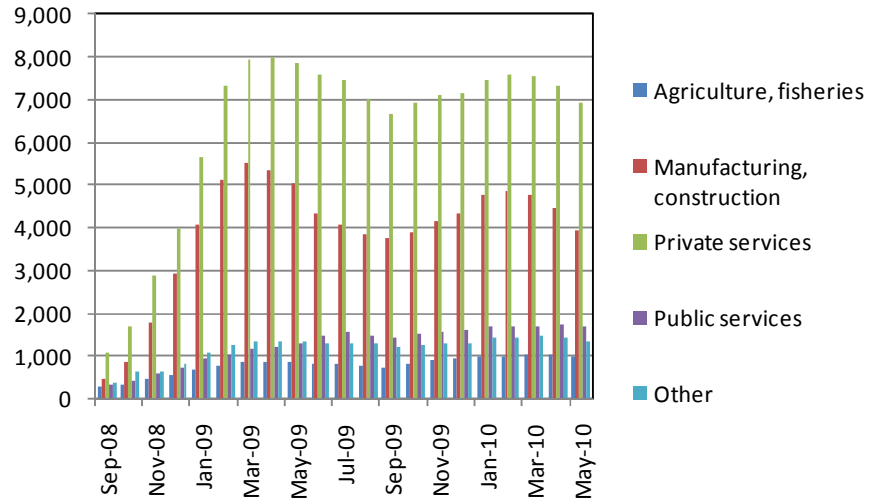


Figure 8 Unemployment by sectors September 2008-May 2010.
Source: Directorate of Labour.

Unemployment immediately before and after the crisis was highest among clerical and sales workers, but increased quite fast among skilled workers, farmers and fishermen. It is interesting to note that unemployment in 2010 did not vary greatly between professions.

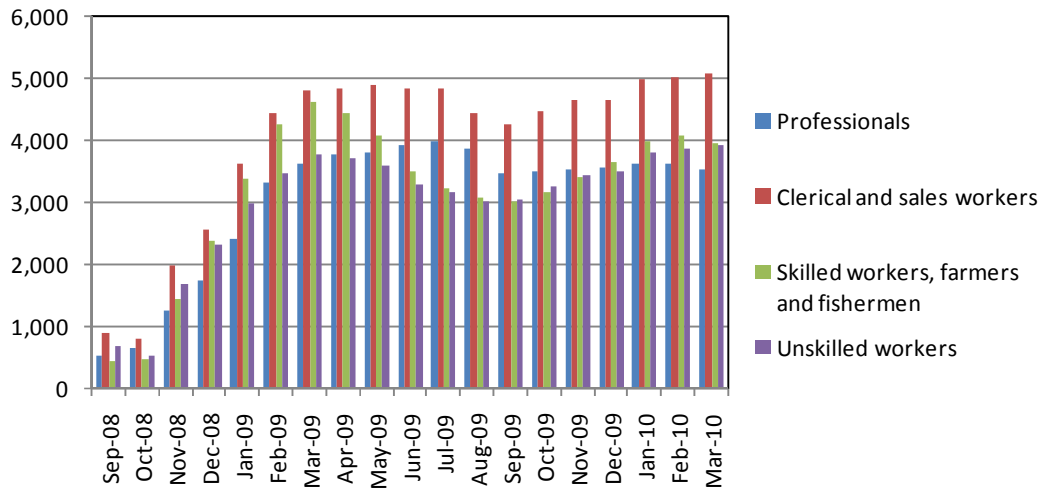


Figure 9 Unemployment by profession September 2008–March 2010.
Source: Directorate of Labour.

The structure of the economy in the capital region differs substantially from the economy in most rural areas.² The job market is more varied in the capital and most individuals with special skills or education are able to find a suitable position. Outside the capital region, the market becomes much sparser, with most openings found in the primary and secondary sectors, as well as public services. To take an example, agriculture, fishing and fish processing combined accounted for 2 per cent of total production of the capital region in 2008, but services for 57 per cent. In the Westfjords, by contrast, the primary sectors accounted for 45 per cent of total production, and services only for 17 per cent.

Table 1 Share of industries in total production by regions in Iceland in 2008.

	Capital region	South-west	West	West-fjords	North-west	North-east	East	South
Agriculture	0	0	4	4	10	6	4	11
Fishing	1	11	15	24	15	10	8	10
Fish processing	1	8	8	17	2	8	16	8
Industry	7	5	24	4	8	8	18	8
Investment	9	13	7	7	9	9	12	10
Public sector	25	21	22	27	35	32	22	27
Services	57	42	21	17	21	26	20	26

Source: Regional Development Institute and IoES (2010).

Previous shocks to the Icelandic economy – both positive and negative – have usually originated in the fisheries sectors, e.g. changes in market conditions abroad or in total harvest. These have usually affected both rural Iceland and the capital region. By contrast, the boom of 2004-2008 owed more to other factors than changing fortunes of the fisheries, and consequently affected the capital area much more than the rest of the country. As revealed in Table 2, the economies of the capital region and the southwest grew by 41 and 44 per cent respectively in the years 2004-2008, while the economies of the northwest and northeast declined by 3 and 5 per cent respectively over the same period! The growth of Eastern Iceland can almost solely be attributed to investments in hydro power and an aluminium smelter.

Table 2 Economic growth by regions 2004-2008.

² Regional Development Institute and IoES (2010). Report can be found at http://byggdastofnun.is/static/files/Skyrslur/Hagvoxtur_landshluta_2003-2008.pdf.

	Capital region	South-west	West	West-fjords	North-west	North-east	East	South
2004	10	4	0	3	2	1	1	5
2005	7	3	10	4	-3	1	31	3
2006	7	7	10	-3	-7	-9	10	9
2007	10	23	-5	-8	2	-4	9	-1
2008	2	3	2	9	1	5	-17	3
2004-2008	41	44	18	3	-5	-6	31	20

Source: Regional Development Institute and IoES (2010).

Given the vast differences in the structure and economic growth of the economies of the different regions it is not surprising that unemployment also varies a great deal. As showed in Figure 10, unemployment is by far highest in the southwest of Iceland, where it averaged 11.8 per cent in the period September 2008-April 2010. If the months of 2008 are excluded, average unemployment in that region jumps to 13.3 per cent. Unemployment in the capital area averages 7.8 per cent for the whole period, and 9.1 per cent for 2009 and 2010. Other regions have fared much better. In the Westfjords, Northwest and East unemployment averaged 2.4, 3.2 and 4.1 per cent respectively for 2009-2010, while it was in the 5.3-7.3 per cent range for the other three regions.

As mentioned above, unemployment has so far not hit the primary or public sectors as heavily as most other industries. These sectors form the backbone of economic activity in many regions outside the capital and the southwest, and because of that these regions have not yet at least faced similar difficulties in the labour market as the capital region.

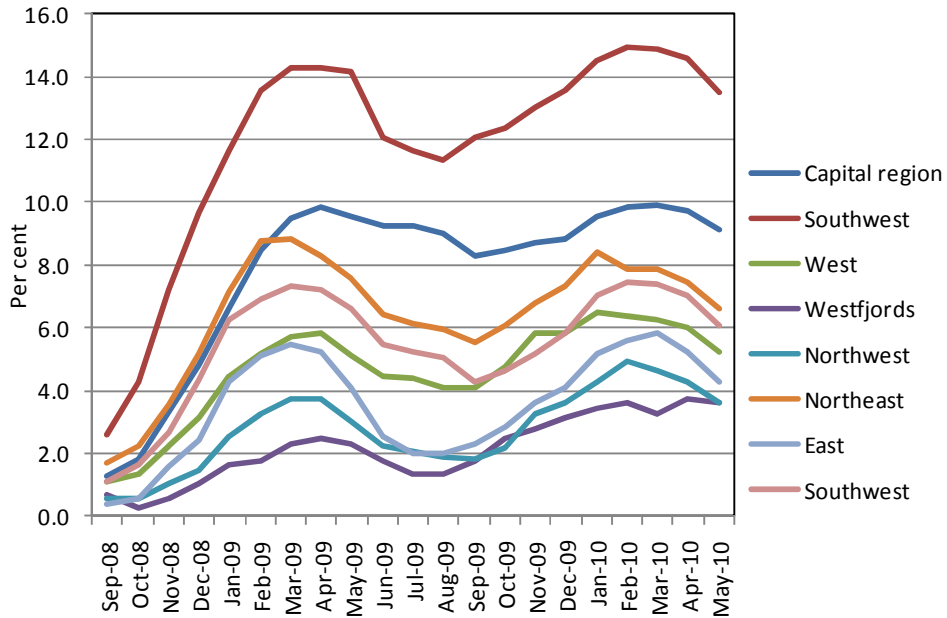


Figure 10 Unemployment by regions September 2008-May 2010.
 Source: Directorate of Labour.

Reliable data does not exist on the incident of unemployment among individuals by nationality. Foreign workers, who are only staying temporarily in Iceland, are reported late, if at all, in Statistics' Iceland Labour Force Survey. Foreigners who claim unemployment benefits are registered at the Directorate of Labour, but without solid information on the number of foreigners active in the labour market it will prove difficult to estimate unemployment by nationality. Figure 11 therefore only reveals how many of those unemployed each month were of Icelandic, Polish or other nationality. Of the 14,900 individuals who were registered unemployed in May 2010, 12,600 were Icelandic citizens, 1,300 Polish and 1,000 of other nationality.

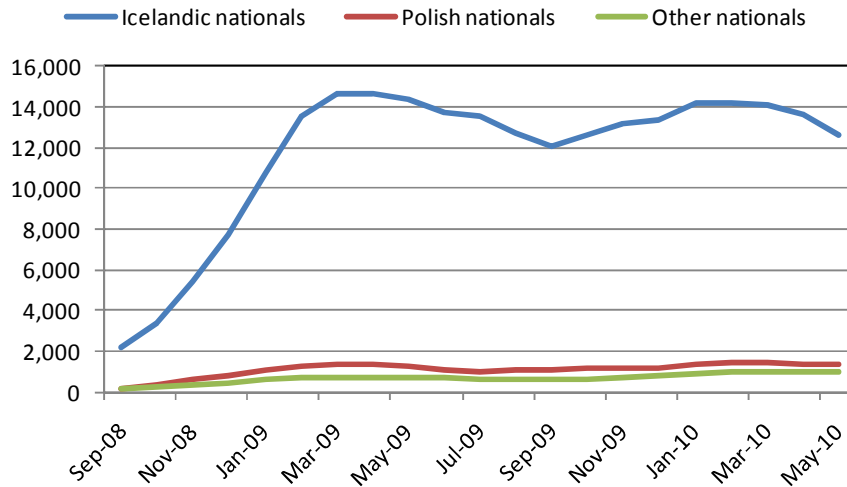


Figure 11 Unemployment by nationality September 2008-May 2010.
 Source: Directorate of Labour.

1.3 Hours worked and full-time employment

As in previous slowdowns the number of hours worked has declined following the crash. The quarter-on-quarter changes in the average workingweek show a drop of 1.5-2.8 hours in the fourth quarter of 2008 and in 2009. Full-time employment has declined continuously since the last quarter of 2008. In the first quarter of 2008, 76.6 per cent of all employees were working full-time, but by 2010 full-time employment had fallen to 72.7 per cent. Reducing workers' weekly hours and increasing part-time work, thus keeping more people employed, facilitates the adjustment in demand, as individuals' income remains higher than it otherwise would have been. It also reduces the loss of human capital. Re-training costs will also be lower once demand starts picking up again. Conversely, workers may find themselves stuck in possibly redundant jobs and sectors, which could result in higher unemployment as the economy starts to move forward again.

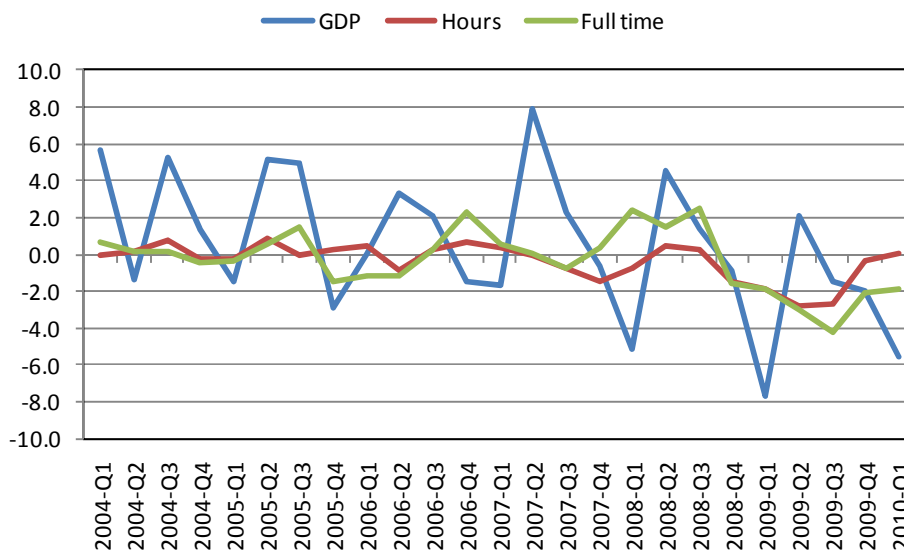


Figure 12 Quarter-on-quarter per cent changes in GDP, percentage points changes in full-time employment and changes in number of hours worked 2004-2010.
Source: Statistics Iceland.

1.4 Migration

Icelandic workers have typically responded to changes in demand by exiting the labour market, reducing the number of hours worked per week, working part-time instead of full-time, and by migrating abroad. This is clearly illustrated in Figure 13 where migration of Icelandic and foreign nationals is plotted against GDP growth. All major recessions in Iceland have been followed – with a lag – with migrations of Icelandic nationals abroad. In most cases these have been workers searching for new employment opportunities, but many were also taking advantage of the poor labour market conditions to further their education. Figure 13 also reveals that Icelandic nationals emigrating abroad have in most years outnumbered those returning home. The severity of the present crisis is well illustrated by the fact that more Icelandic nationals emigrated in 2009 – almost 2,500 – than in any other one year in the past century.

Iceland is a founding member of the European Economic Area (EEA) established in 1994 between members of the European Union of the time and the EFTA countries Iceland, Lichtenstein and Norway. Citizens of countries within the EEA do not need any work permit in Iceland, but citizens of countries outside the EEA must obtain a limited work permit before arriving to work in Iceland.³ Under EEA agreements, the Icelandic government is under obligation to give workers from member states priority on the domestic job market. A temporary work permit may, however, be granted due to specific jobs in Iceland when employees cannot be found either on the domestic labour market or within the European

³ Does not apply to Rumanian and Bulgarian nationals, who until 2012 will need permits to work in Iceland.

Economic Area, the EFTA states or the Faroe Islands. The number of foreigners migrating to Iceland has increased since the EEA agreement came into effect, not least in the boom years 2003-2008, when the net immigration of foreign nationals equalled 17,600 persons. Some of these were migrant workers employed on the big hydro and aluminium projects undertaken in the east of Iceland during this period and many of these left the country shortly after the projects ended. Poles are most numerous among the immigrants. In all, some 10,100 Poles migrated to Iceland during the years 2005-2008. That corresponds to about 40 per cent of the total number of immigrants since 1986. Many also immigrated from the Baltic states and Thailand.

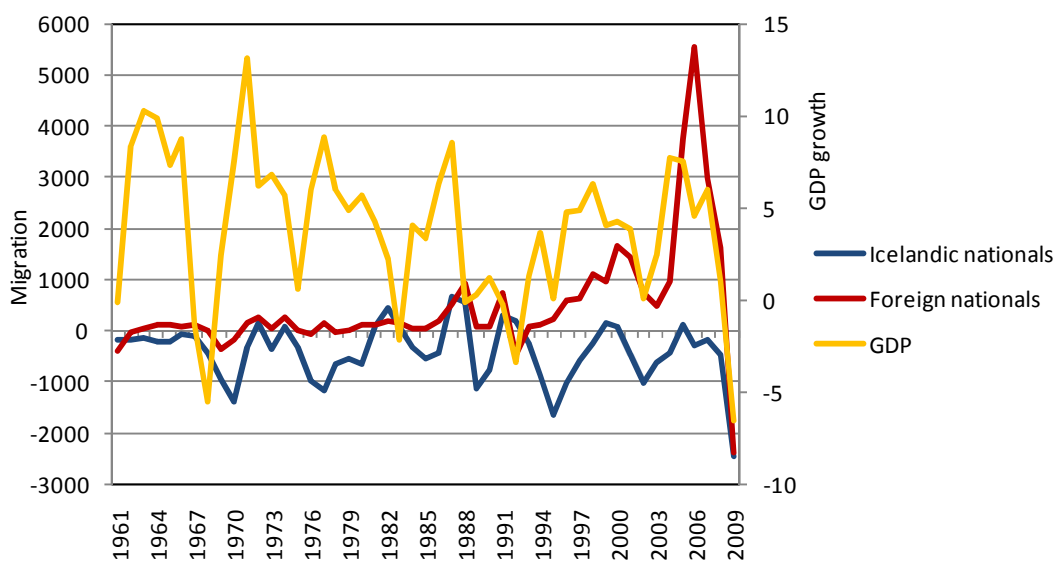


Figure 13 Internal migration and GDP growth 1961-2009.
 Source: Statistics Iceland.

1.5 Wages and productivity

Developments in the labour market in the near future will to a large extent be dictated by development of wages. Wages as a share of gross factor income have increased rapidly in the last two decades. In 1991, wages amounted to 60 per cent, but by 2007 the share had risen to 71.6 per cent. Since then wage share has fallen dramatically, and was estimated as 56.8 per cent of factor income in 2009.

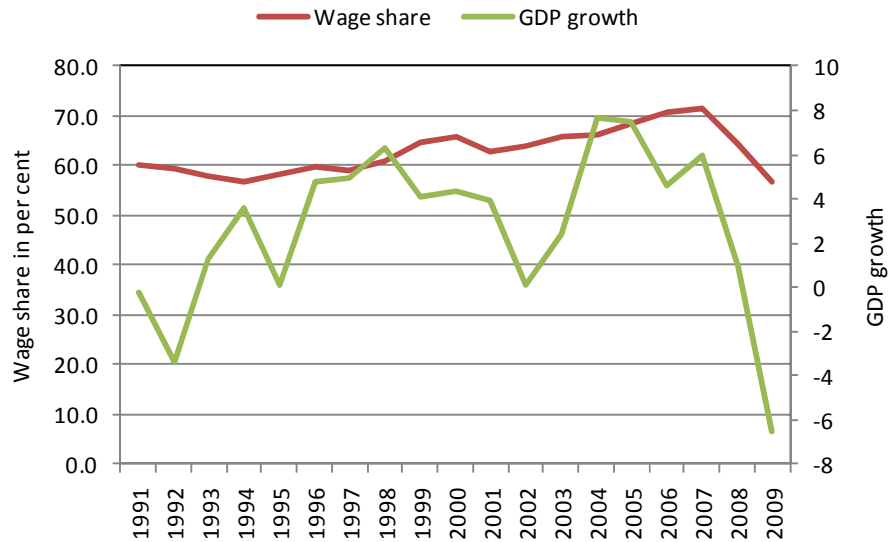


Figure 14 Share of wages in gross factor income and GDP growth 1991-2009.
Source: Central Bank Monetary Bulletin 2010-2.

Although the share of wages had become quite high, the fall in recent years probably exceeds that needed for correction. It is therefore likely that wage pressures will build up in the near future, not least in the export and import competing sectors which are enjoying the consequences of the fall of the Icelandic krona. As part of the tri-party Stability Pact between labour, management and government that was signed in June 2009, general wage settlements were frozen until November 2010. Demands for higher wages have already been voiced, but the current unemployment situation may limit the aggressiveness of the unions. Rising profits in the export sectors could, on the other hand, lead to higher wages in that sector, which could then spill over to other branches and raise unemployment in the non-export sectors.

According to the calculations of the Icelandic Central Bank, productivity of the labour force rose in the wake of the financial collapse. Total hours worked are estimated to have fallen by nearly 11 per cent in 2009, while GDP contracted by 6.5 percent. Output per hour therefore rose by nearly 4.7 per cent, while underlying productivity in terms of man-yers increased by about 2.5 per cent. Similar behaviour has been observed in previous recessions.

In Figure 15, changes in nominal wages and other labour costs are compared to changes in trend labour productivity, with the latter shown as negative contributions to labour costs. The rise in productivity in 2009 is well documented. Rises in payroll tax caused other labour costs than wages to grow in 2009 and 2010, but further rises are not expected in the ensuing years. The Central Bank believes nominal wages will rise by 4.2 per cent in 2010, 4.9 per cent in 2011 and 5.8 per cent in 2012. As mentioned above, favourable conditions in the export sector could even push wages higher.

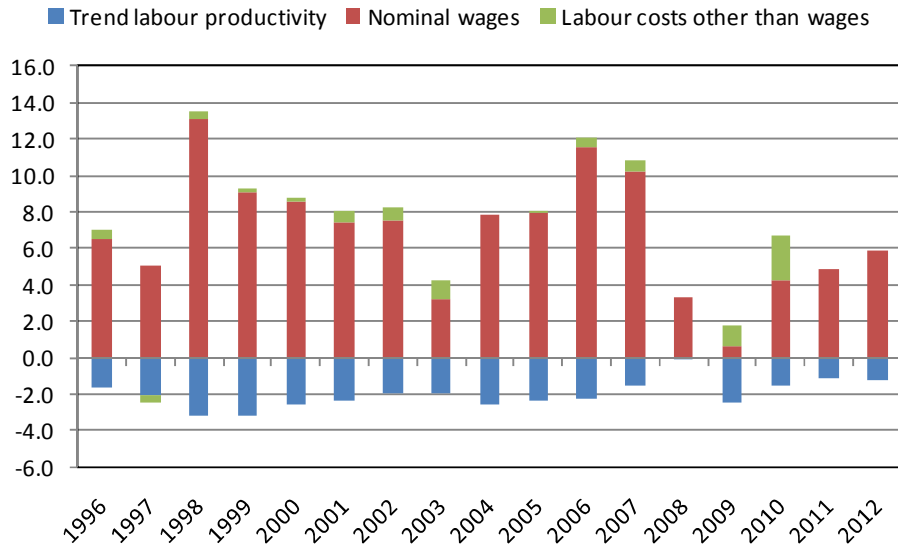


Figure 15 Wages, other labour costs and productivity 1996-2012.
 Source: Central Bank Monetary Bulletin 2010-2.

1.6 Vacancies and hires

The number of vacancies increased rather quickly in the beginning of the recession, but in the last nine months the number of new registered jobs at the Directorate of Labour has somewhat tailed off. In March, April and May 2010, the number of vacancies in fact declined from the corresponding month a year earlier. The number of confirmed hires has also fallen.

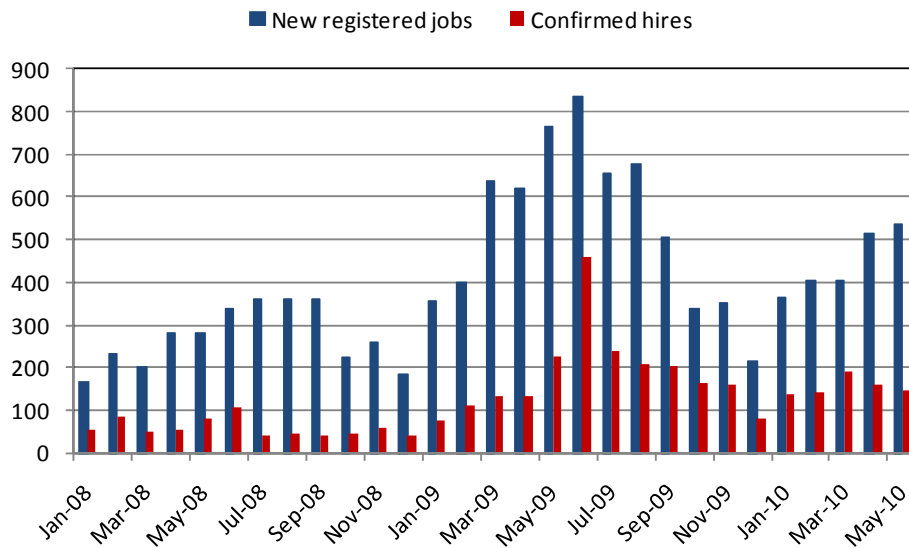


Figure 16 New registered jobs and confirmed hires January 2008-May 2010.
Source: Directorate of labour.

Immediately before the recession hit Iceland, new registered jobs amounted to 14-16 per cent of the number of unemployed persons. This ratio fell to 2-4 per cent in the first months of the crisis, and although the ratio of new jobs to unemployment rose slightly again, it has remained around 2 per cent in recent months. Confirmed hires have in the last half-year only corresponded to about 1 per cent of the number of unemployed persons.

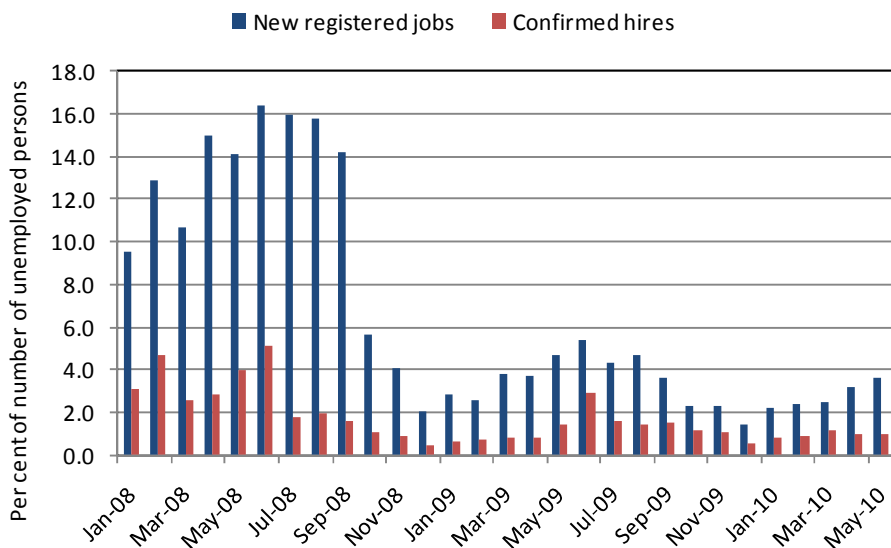


Figure 17 New registered jobs and confirmed hires January 2008-May 2010 as per cent share of unemployment.
Source: Directorate of labour.

1.7 Business expectations

Business expectations concerning the labour situation have remained stable in recent months, according to the Capacent Gallup Consumer Sentiment Index. In the survey carried out in May and June 2010 among Iceland's 400 largest firms, 14 per cent of businesses were planning recruitment in the next 6 months, but 28 per cent planning redundancies. More firms are now planning to layoff workers than in the March survey. A survey carried out by the Confederation of Icelandic Employers among its members in April indicated that net reduction in staffing in 2010 could amount to 1,500 employees. That corresponds to a rise in unemployment of almost one percentage point. Taken together, the two surveys indicate that the labour market has yet to weaken somewhat. However, the rate of deterioration appears to have diminished.

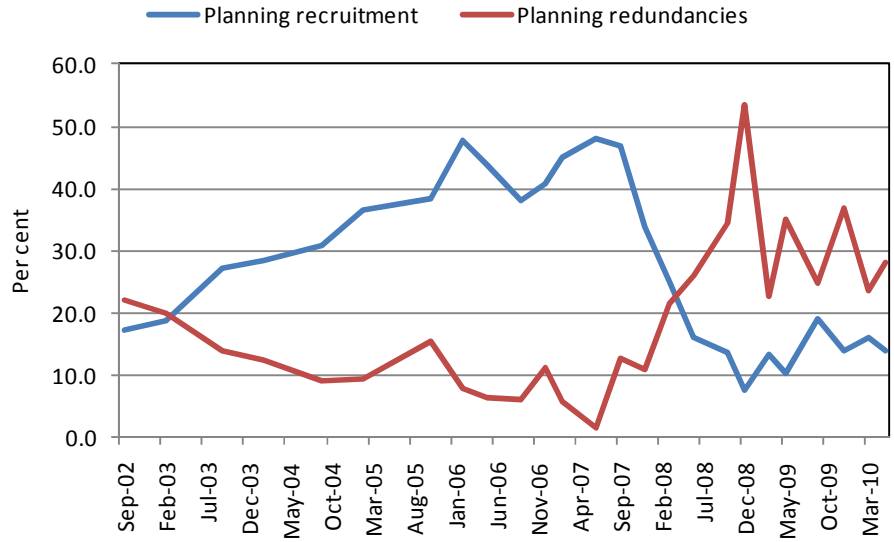


Figure 18 Recruitment and redundancies plans of businesses over the next six months.
 Source: Central Bank Monetary Bulletin 2010-2.

In Figure 19, the expectation of individual industries are explored a little further. The Sentiment Index takes on a value between 0 and 200, where a value of zero indicates that every firm in that line of economic activity is planning redundancies in the next 6 months, and a value of 200 that every firm is planning recruitment. A value of 100 indicates that equally many believe they will have to layoff workers and add to their workforce. The lowest value of the index is recorded for construction and utilities, where half of the firms in question believe they will need to layoff workers in the coming months. Finance and insurance is the only branch where managers are really optimistic about the future, and believe hires will outnumber firings.

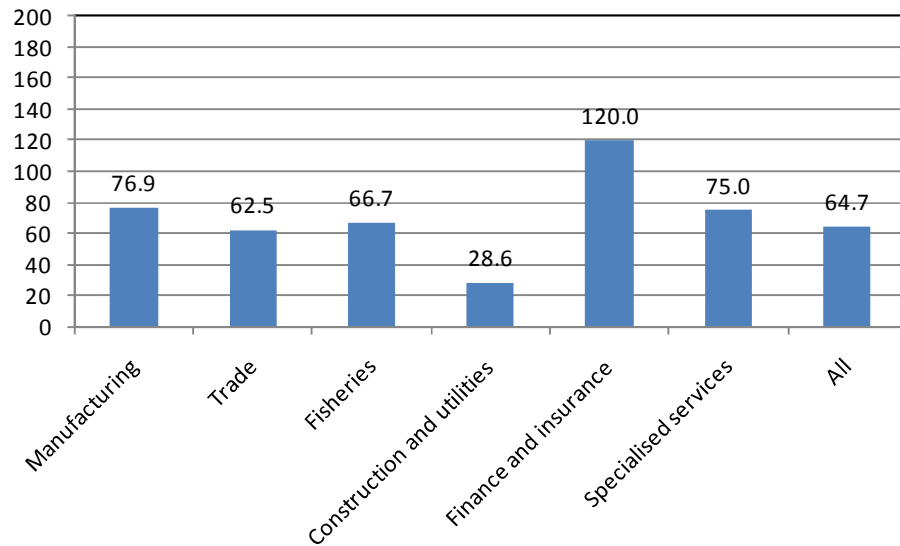


Figure 19 Recruitment and redundancies plans of individual industries in May/June 2010.
Sentiment Index.

Source: Capacent (2010).

The Capacent survey also reveals how managers feel about the current economic situation and what hopes they harbour for the next 6 and 12 months respectively. As Figure 20 indicates, the optimism of the boom period has been completely eroded. Thus, the Sentiment Index for the current situation takes on a value of 1.4, which can be interpreted as meaning that almost everyone believes the current economic situation is bad. The corresponding index for the situation in 6 months time takes a value of 105.2. This marks the first time in three years that more people expect the economic situation to improve in the next 6 months. The latest Capacent survey does not provide information on expectations of the situation 12 months from now, but the Sentiment Index has hovered around 145-150 since October 2008. Interestingly, however, managers appear to be a little bit more pessimistic about the situation a year from now than they were last year.

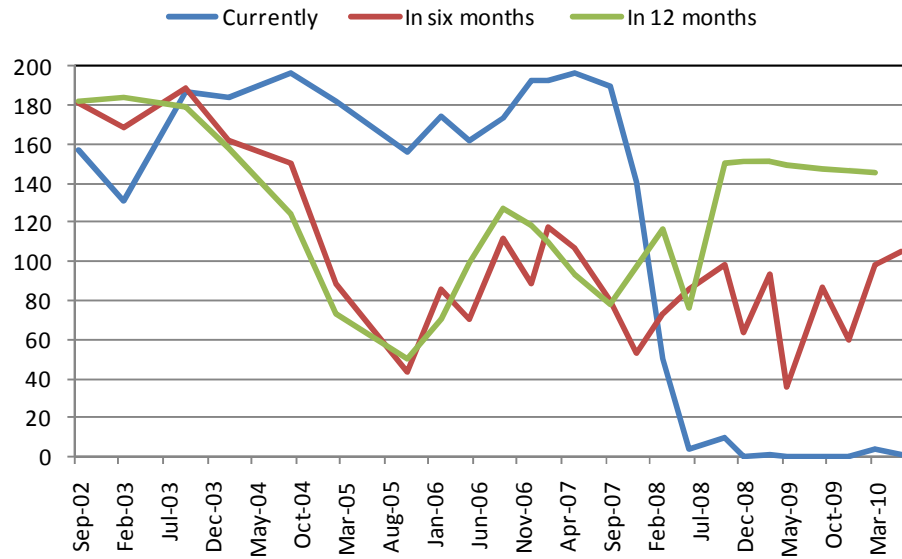


Figure 20 Managers' views of the economic situation. Sentiment Index.
Source: Capacent (2010).

2 Policy

2.1 Economic policy

Following the crunch in the autumn of 2008, an IMF-supported recovery programme was introduced in Iceland. Due to the fact the Icelandic economy – both firms and households – was highly leveraged, and that most of the debt was either demonimated in foreign exchange or indexed to inflation, the primary short-run aim of the programme was to stabilise the Icelandic krona. To this end, restrictions were placed on capital movements and the central bank has maintained higher interest rates than in all neighbouring countries. Restructuring of Iceland's three largest banks was completed in December 2009, and extensive reforms of financial market regulations are also being carried out.

When the Icelandic bank Landsbanki failed in October 2008 and Iceland's private deposit insurance fund was unable to pay claims to owners of the so-called Icesave deposit accounts in the UK and Netherlands, governments in the two countries stepped in to pay out the deposit insurance obligations to the depositors. The sides, Iceland on the one hand and the UK and Netherlands on the other, have since been unable to finalise an agreement on how to resolve the deposit insurance claims. A government-to-government agreement was though reached in October 2009, but rejected resoundingly in a referendum by Icelandic voters. As of date, the issue remains unresolved.

Although fiscal consolidation is a vital part of the recovery programme, the automatic fiscal stabilisers were allowed to work during the first years of the programme, as it was deemed impossible for Iceland to tighten its belt in the middle of the recession. As shown in Figure 21, the overall fiscal balance showed a 5.4 per cent surplus in 2007, but a 13.5 per cent deficit a year later. This was mostly due to increases in expenditures, which rose from 42.5 per cent of GDP in 2007 to 57.8 per cent in 2008. Revenues, on the other hand, remained a relative stable proportion of GDP. In the medium-term the aim is though to consolidate the government finances. Thus, according to the plan laid out in the 2010 budget, the government deficit will amount to 5.6 and 1.4 per cent in 2010 and 2011 respectively, whereas a 2.2 and 5.1 per cent surplus is forecast for 2012 and 2013 respectively. These projections do not take into consideration eventual interest payments associated with an agreement on Icesave.

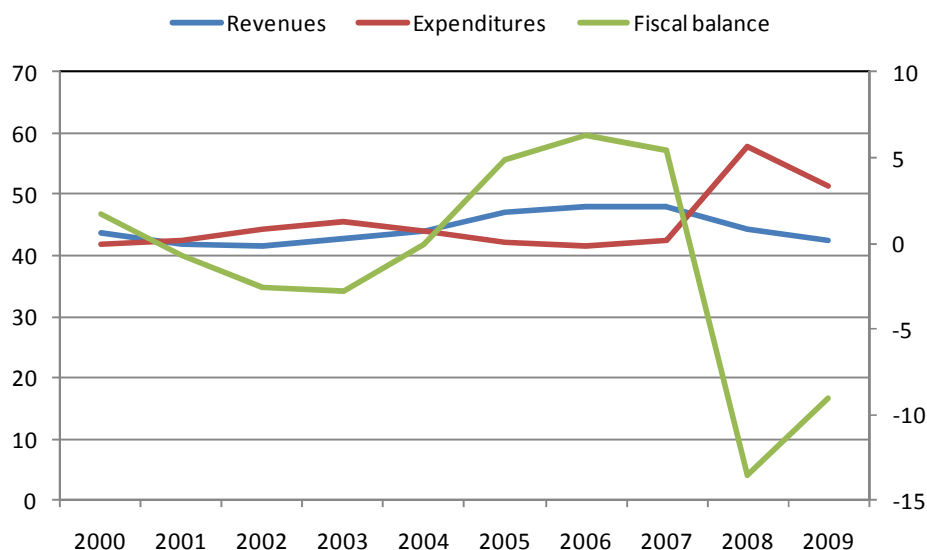


Figure 21 Public sector finances 2000-2009 as per cent of GDP. Rvenues and expenditures on left axis, fiscal balance on right axis.
Source: Statistics Iceland.

To achieve its objective of fiscal consolidation, the government aims to both reduce expenditures and raise revenues. Thus, various austerity measures in the 2010-budget reduced expenditures by almost 10% from the previous years, including considerable cuts in public investments. At the same time, various unemployment related expenses – primarily unemployment benefits – are expected to rise, and higher interest payments will also cut into government finances. Taken together, government expenditures are therefore not expected to change much between the years 2009 and 2010. Instead most of the initial adjustment in the government budget will take place on the revenue side. In mid-2009, the government introduced 8.0 per cent surtax on income, but abandoned the tax 6 months later when a new multi-rate personal income tax came into effect. Rates on the lowest income groups though remained the same. Capital gain taxes and corporate income taxes were raised from 15 per cent to 18 per cent, and the standard rate of VAT from 24.5 per cent to 25.5 per cent. Social security contributions were also increased from 5.34 per cent to 7 per cent in mid-2009, and further to 8.65 in 2010. These increases in revenue will account for the largest share of the projected improvement in public finances in 2010. Future improvements will have to be financed to a greater extent by expenditure cuts, with the scope for further tax increases limited.

The development of inflation and the value of the Icelandic krona in the last decade are documented in Figure 22. Inflation is measured as the annualised 12 month rate, and developments of the krona are proxied by a broad merchandise index which takes a value of

100 in January 2000. The value of the krona peaked in November 2005, but had by September 2008 declined by over 40 per cent. The exchange rate deteriorated immediately after the crisis and the index stood at 46.1 points in November 2008. In May 2010, the index showed a value of 48.4 points.

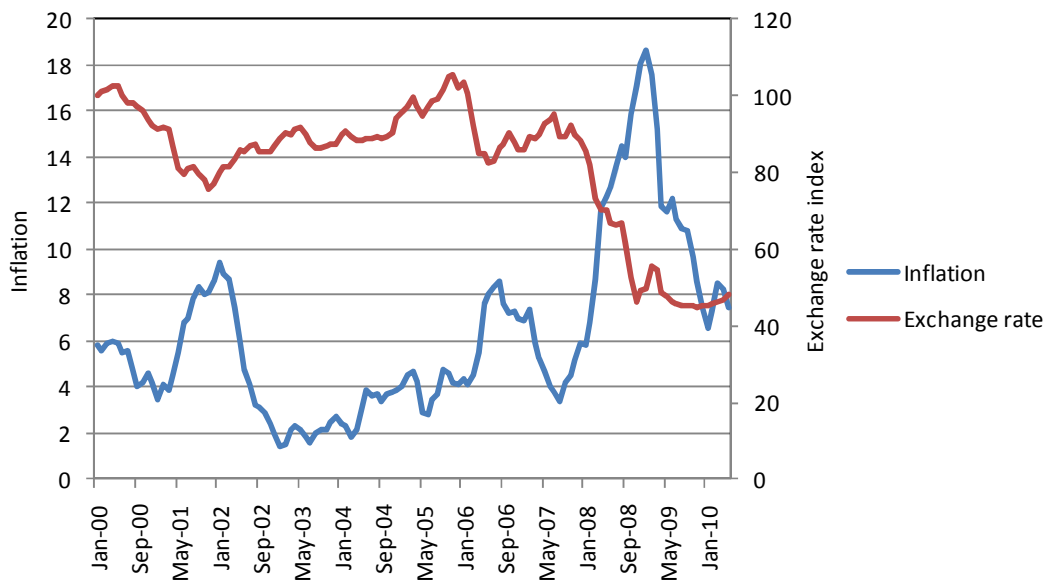


Figure 22 Inflation in Iceland 2000-2010. Annualised 12 month rate.
 Source: Statistics Iceland.

Inflation at the beginning of the year 2008 measured just under 6 per cent and continued to rise throughout the year. It peaked in January 2009, when the annualised 12 month rate amounted to 18.6 per cent. Since then inflation has come down, but at a much slower rate than had been hoped.

2.2 Labour market policies

2.2.1 Tax and social security

Higher taxes on business – both the corporate profit rate and social security contributions – reduce demand for labour, and can therefore not be expected to have a positive effect on the employment level. The government has been criticised for attempting to close the deficit by raising taxes rather than cutting down on expenditure, which critics believe will delay recovery more than a larger cut in public spending. Given the precarious state of public finances it has been argued that the government must leave much of the recovery to the market, as the authorities are unable to engage in much employ-stimulating activity.

2.2.2 Households

Shortly after taking power in February 2009, the current government introduced the first steps of a comprehensive action plan aimed at helping families in financial troubles. These included the following measures:⁴

1. Execute extensive measures in housing matters.
 - a. Lessen by the introduction of new laws, the debt load of individuals with cost indexed loans by using a payment equalization index.
 - b. Intensify and increase the number of ways the Housing Finance Fund can help people with financial difficulties, such as by lengthening and restructuring loans, by giving them more flexibility, and by increasing their authorization in dealing with the collection of debts.
 - c. Give the Housing Finance Fund legal permission to rent out housing owned by the Fund and increase solutions available for people with financial difficulties. Permission will be given to seek collaboration with town councils or other institutions for contracts.
 - d. Necessary temporary changes in laws and regulations will be made to allow the cancellation of various fees involved in the changing of terms and stipulations of contracts. These charges, such as stamp duty and registration charges make restructuring or paying up of loans difficult.
2. Temporarily cancel the right of authorities to utilize child compensation towards public taxes.
3. Cancel the right to utilize interest compensation towards repayment of loans with the Housing Finance Fund.
4. Child compensation will be paid out monthly, not every three months as at present.
5. Public collectors will be given temporary authorization to show flexibility when negotiating the settlement of outstanding debts, depending on the circumstances of the individuals involved.
6. Pass a temporary law giving collectors for the State Treasury authorization to waive penal interest, charges and fees in certain well defined and specified cases.
7. Issue a request to all ministries and government establishments to soften as far as possible all debt collecting processes with individuals, including limiting as much as possible the percentage of income the state can utilize towards the lowering of debts.
8. Laws regarding penal interest will be revised with the aim of lowering the rate.

Household debt restructuring has also been managed as a voluntary process within the financial system. The measures undertaken so far – both those initiated by the government and the financial sector – seem to have been too limited and it is clear that further debt relief is needed to solve the situation for many households. Recent reports published by the Central Bank and Statistics Iceland though show that the problem of over-leveraged households can

⁴ The statement can be found at <http://www.mcc.is/english/news/news/nr/880>.

not entirely be traced to the current recession.⁵ Many households had taken on way too much debt during the boom years, and it was obvious that some of those would hardly be able to service the mortgages and loans for durable consumption that had been acquired.

2.2.3 Unemployment benefits

Employees and self-employed persons aged 16-70 are entitled to unemployment benefits on condition that they have the right to unemployment insurance and are unemployed and actively seeking work, have their residence in Iceland and are able to work and ready to be hired for all general work anywhere within the country.⁶ The entitlement to benefits is based on work and employment ratio during the past 12 months. The benefits are of two kinds; earnings-related benefits and basic benefits. Earnings-related benefits are calculated as 70 per cent of total average wages during a period of six months, ending two months prior to the application date. Currently, maximum benefits amount to ISK 242,636 per month. Earnings-related benefits can be obtained for three months during each benefit period. After three months of earnings-related payments, basic unemployment benefits are paid out. The full basic benefits amount to ISK 6,900 per day or ISK 149,514 per month. Minimum benefit entitlements are based on at least 25 per cent of full-time work during three months.

Each benefit period is 3 years, and a new benefit period can not begin until at least 24 months have passed since the earlier period ended. To obtain a renewed benefit entitlement, the individual concerned must have worked for at least 6 months after the end of the previous period.

Following the crisis, certain amendments were made to the Unemployment Benefits Act that allowed employees to spread the earnings-related benefits over a longer time period.⁷ This special provision applied to employees who had been forced to take up part-time work. Thus, individuals who because of deficient demand were now working 75 per cent were entitled to 25 per cent of the earnings-related benefits for up to 12 months. Similarly, an individual working half time was entitled to 50 per cent of the earnings-related benefits for up to 6 months. In May 2010, 1,350 individuals were receiving partial benefits on the basis of this provision. Once the earnings-related benefit period is finished, the employee can claim partial basic unemployment benefits. At first, this provision was only intended to apply to the period ending April 30th 2009, but the duration has since been twice extended and will now run out at the end of June 2010.

According to the Unemployment Benefits Act, individuals are defined as self-employed if the level of operation of their own company or private business is such, that they are required each month or on otherwise regular basis to submit payments for estimated income taxes and social security contributions. Self-employed individuals that have submitted such payments

⁵ The Central Bank report is available at <http://www.sedlabanki.is/lisalib/getfile.aspx?itemid=7806> and the report from Statistics Iceland at <https://hagstofa.is/?PageID=421&itemid=daa4d5a9-3cfb-428a-a262-b7099201cfa4>.

⁶ Act nr. 54/2006 with later amendments.

⁷ Act nr. 131/2008.

regularly for a minimum period of 12 months qualify for employment benefits. However, in order to qualify for full benefits, their average earnings must equal benchmark incomes that vary between industries.⁸ Thus, an individual who is deemed to have on average earned 75 per cent of the benchmark would be entitled to 75 per cent unemployment benefits. As in the case of ordinary employees, the level of their income-related benefits depends on their average earnings.

It is not necessary for self-employed individuals to close down their operation completely in order to qualify for unemployment benefits. In the case of severe difficulties that have resulted in a very limited level of operation, self-employed individuals may be entitled to unemployment benefits in addition to income from their own business. Earnings in excess of ISK 100,000 per month are though deducted from the unemployment benefits. Self-employed individuals can only claim benefits for three months according to this provision. In May 2010, around 100 self-employed individuals were receiving these benefits. This amendment to the Unemployment Benefit Acts runs out at the end of June 2010.

Recent changes to the Unemployment Benefit Act have also reduced the right of students to claim unemployment benefits.⁹ Students, who have attended school or university in the previous semester and intend to carry on in the next semester, are thus now longer entitled to benefits. Traditionally rather few students have been registered unemployed during the school-holidays, as most interested in seeking a job have in the past found a suitable position. However, the difficult situation of students crystallised in the summer of 2009, when unusually many registered for unemployment benefits.

Finally, recent changes in the Unemployment Benefit Act have emphasised increased means testing.

2.2.4 Labour market measures

According to the Labour Market Measures Act, job seekers may apply to participate in labour market measures organised by the Directorate of Labour.¹⁰ These measures can be classified in the following manner:

- Individual courses, such as courses on drawing up employment search schedules or self-improvement and courses to improve competence in particular areas.
- Vocational remedies; job introduction, vocational training and trial engagements.
- Counselling, provided concurrently with participation in course and trial engagements.
- Studies.
- Employment-related rehabilitation.
- Employment-related rehabilitation for specific groups.

⁸ Act nr. 37/2009.

⁹ Act nr. 134/2009.

¹⁰ Act nr. 55/2006 with later amendments.

In January 2009, a new regulation on labour market measures offering the following measures came into effect:¹¹

- **Training.** Basic unemployment benefits may be used to subsidise training for up to 6 months, with the Directorate of Labour paying an additional 8 per cent pension contribution. The aim is to train employees in the specific skills needed to work in the industry in question.
- **Trial periods.** Basic unemployment benefits may be used to subsidise hirings for a trial period of up to 6 months, with the Directorate of Labour paying an additional 8 per cent pension contribution.
- **Studies.** ¹⁾ Job-seekers can obtain permission to enroll in study programmes that will strengthen their standing in the labour market, or able them to pursue further studies. These include various vocational studies and preparatory courses for university. Loans from the Icelandic Student Loan Fund are not offered to students in these programmes. The duration of the studies is usually limited to one semester, but may in some circumstances be extended to two semesters. ²⁾ Job-seekers, who wish to remain active in the labour market, can also attend evening- or weekend-courses at secondary school or other shorter courses offered. ³⁾ Financial support may be obtained for up to half of the study cost, though no more than ISK 70,000 per semester.
- **Employment-related rehabilitation.** Basic unemployment benefits may be used to subsidise rehabilitation for up to 13 weeks, with the Directorate of Labour paying an additional 8 per cent pension contribution. These measures are intended for individuals with reduced work capacity.
- **Development of business plan.** Job-seekers developing business plans may receive basic unemployment benefits for up to 6 months. If the plan is deemed likely to bear fruit benefits may be paid out for additional 6 months.
- **Innovation.** Firms seeking employees to work on innovation projects can submit their business plan to the Directorate of Labour, which together with Innovation Center Iceland, evaluates the proposal. Basic unemployment benefits may be used to subsidise hirings for a period of up to 6 months, with the Directorate of Labour paying an additional 8 per cent pension contribution. The period can be extended for additional 6 months.
- **Special projects.** Local and central government, public enterprises, legal entities and non-profit organisations may seek employees to take part in well defined special projects. Basic unemployment benefits may be used to subsidise hirings for a period of up to 6 months, with the Directorate of Labour paying an additional 8 per cent pension contribution. The period may not be extended.
- **Volunteer work.** Non-profit organisations may engage job-seekers in volunteer work. The organisations may receive basic unemployment benefits for a period of up to 6 months.

¹¹ Regulation nr. 12/2009.

The number of individuals taking part in labour market measures has increased substantially in the last few months. In May 2009-December 2009, there were on average around 1,300 individuals engaged in the various measures, but they averaged 2,800 in the first 5 months of 2010.

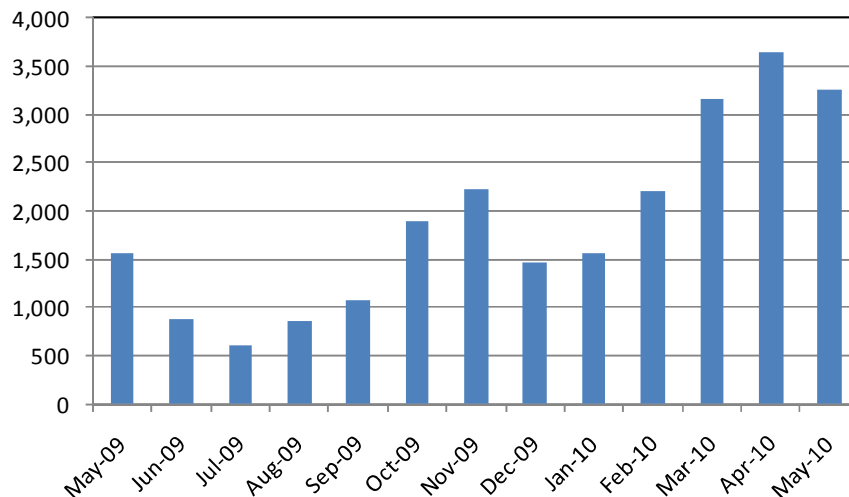


Figure 23 Number of individuals taking part in all labour market measures each month May 2009-May 2010.

Source: Directorate of Labour.

In 2009, a little over 6.900 individuals took part in some labour market measures. Most were study-related activities, with only 586 training and trial periods. The share of those furthering their education has though increased, while the number of those engaged in basic measures has fallen. Young people figure prominently among those taking advantage of these measures. In May 2010, one in four was aged 16-24. Just over 400 foreign nationals were then taking part. Most were improving their knowledge of Icelandic language and society.

Table 3 Number of individuals engaged in various labour market measures in 2009 and May 2010.

	2009	May 2010
Basic measures	1,379	388
Workshops and clubs	481	233
Courses in languages, computer and clerical work	1,196	779
Job-related courses	668	330
Study agreements	1,435	799
Training and trial periods	586	266
Special projects	151	90
Innovation projects	514	147
Other funded courses	245	
Education and Training Service Centre	265	221
Total	6,920	3,253

Source: Directorate of Labour.

2.2.5 Employment creation

In the Stability Pact of June 2009, the government vowed to pave the way for major projects already schedules in macroeconomic plans. Concerted effort was also to be made to move forward on plans for other major industrial investments. In addition, the government intended to enlist the co-operation of Iceland's pension funds to finance major projects.

Todate, most of these projects are still on the drawingboard. The difficult state of the government's finances has made it neigh impossible for it to engage in any labour-intensive projects, and the pension funds have so far not committed themselves. The government has though announced that work will shortly commence on the building of new nursery homes in several communitites which will hopefully create 1,200 new jobs, and that more funds will be allocated to renovation of government buildings this summer. However, the anticipated large energy and heavy industry projects have yet not materialised. Work is though expected to commence on a hydro project later this year.

In late 2009, the government introduced new measures to reduce unemployment, targeting young people and the long-term unemployed. The programme aims to offer every individual that becomes unemployed another job within three months, or the opportuntiy to further her education or other kind of activity. While the emphasis is on encouraging the unemployed to invest in their human capital, it is hoped up to 450 new trainee positions will be created, as well as 400 volunteer jobs and 400 vacancies at workshops and rehabilitation centres. The government hopes that up to 2,400 unemployed will be able to take advantage of these policies, and the objectives of the programme will be met for those younger than the age of 25 by 1 April 2010, end by July 1 for those older.

As mentioned above, students now longer qualify for unemployment benefits. To counter this, it was decided to allocate ISK 250 million from the Unemployment Insurance Fund to finance

summer jobs for students. In all it was hoped that some 830 jobs could be created. Previously the government and City of Reykjavik had jointly decided to strengthen the Student Innovation Fund, and thus create 400 summer jobs for students.

In mid-June, many of these positions had still not been filled. There was a huge interest – around 1.700 students applied – in the summer jobs and evaluation of applicants proved consequently more time consuming than had been anticipated.

Both local and central government have placed considerable emphasis on stimulating innovation, entrepreneurship and the creative arts. Indeed, many summer jobs have been offered in these fields. Since the crisis, seven new innovation centres have been opened throughout the country and according to figures compiled by Innovating Centre Iceland up to 500 new jobs have been created since autumn 2008.

According to an amendment of the Value Added Tax Act, builders of family dwellings and summerhouses will get a refund on all VAT-expenses associated with wage payments.¹² The same applies to owners of dwellings and summerhouses that engage in restorations and repairs. The amendment only applies for work undertaken during the period March 2009 – January 2011.

2.2.6 Policy conclusions

Because unemployment in Iceland has traditionally been relative low, the labour market policies pursued by the authorities have primarily involved inactive measures or the payment of unemployment benefits. The low rate of unemployment can be attributed to several factors, including flexible nominal pay, and access to the Nordic labour market, and later the EEA. As discussed above, basic unemployment benefits are flat rate and these have been close to the value of the minimum wage negotiated by the trade unions. Early retirement schemes have not been available, and although the official pension age is 67, most chose to postpone retirement until the age of 70.

The sudden surge in unemployment following the crunch, and especially the increased number of the long-term unemployed, has called for new and drastic measures. Due to the poor state of public finances, the government has, however, been unable to meet calls for employment-creating projects. Instead the onus has fallen on pension funds and private parties to finance these investments, but as yet these plans have not materialised. Several possibilities have been identified, such as construction of a university hospital and new transport centre in Reykjavik, as well as several other infrastructure projects. Difficulties in securing financing, partly because of the unresolved Icesave issue, and uncertainties regarding foreign investments in heavy industry have prevented Icelandic power companies from pushing on with various geothermal and hydro projects.

¹² Act nr. 10/2009.

Rather than create new jobs the government has therefore opted for a policy mix of active labour market measures and unemployment benefits. The Directorate of Labour offers various options to unemployed individuals, but the success of these measures has not been examined in any detail. Little information is available on how many of those taking part in the measures offered have found a job, and how well they have managed to hold on to these positions. It is imperative to gain a better understanding of the success of these measures, and analyse the successrate by gender and age, as well as profession, industry and region. A thorough breakdown is necessary so that improvements can be made to matching in the labour market. Likewise, better information is needed on the success of various other employment-stimulating activities at local and national level.

Some important amendments to the Unemployment Benefits Act run out in mid-2010. These include the provisions that employees that have experienced reduction in working time because of deficient demand may be entitled for part-time unemployment benefits. Similar provisions apply to self-employed individuals that have been forced to reduce their level of operation. Many employees and self-employed persons have taken advantage of these possibilities, and it would be better if these amendments were extended for a longer period.

Each benefit period is 3 years, and a new benefit period can not begin until at least 2 years have passed since the earlier period ended. Up to now the length of the benefit period has not constituted a major problem, but with increasing long-term unemployment demands for extending the period will doubtlessly surface. Those still unemployed at the end of the benefit period have sought financial support from their respective communities. It is, however, clear that the present – and probably increasing – level of long-term unemployment places too heavy burdens on the economies of most communities, and local and central government need to agree on a method to deal with this issue.